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SMALL BUSINESS ADMINISTRATION

Case Studies Illustrate 8(a) Program and Contractor Abuse

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Madam Chair and Members of the Committee:

We are pleased to be here today to discuss our September 1995 report¹ concerning case studies of two firms that participated in the Small Business Administration's (SBA) 8(a) business development program. The program is designed to promote the development of small businesses that are owned and controlled by socially and economically disadvantaged individuals. Our September report built on earlier work on SBA/8(a) weaknesses.² These included the high concentration of contract dollars among a very small percentage of participating 8(a) firms and a large percentage of 8(a) firms that received no contracts at all. Our report focused, through case studies, on whether individuals or firms had exploited these and other program weaknesses to participate in and benefit from the program. Today we will discuss program and contractor abuses involving 2 of the top 25 8(a) contractors in terms of total dollars awarded in fiscal year 1992.

In summary, our investigation revealed 8(a) program abuse and ineffective SBA oversight of the two firms. During the application process, both firms provided information that gave rise to questions about their eligibility to participate in the 8(a) program, but SBA did not fully resolve those questions before admitting the firms to the program. Further, one firm misrepresented its qualifications to enter and remain in the program. However, SBA's 8(a) program office did not act to suspend the firm's contracts or remove it from the program after learning of the misrepresentations. With regard to the second firm, we questioned the practices of the contracting agency--the Coast Guard. In a contract with the second firm, Coast Guard officials changed the contract's original classification code to one for which the firm qualified and altered the contract's minimum value

¹Small Business Administration: 8(a) Is Vulnerable to Program and Contractor Abuse (GAO/OSI-95-15, Sept. 7, 1995).

²Small Business: Status of SBA's 8(a) Minority Business Development Program (GAO/T-RCED-95-149, Apr. 4, 1995); Small Business: Status of SBA's 8(a) Minority Business Development Program (GAO/T-RCED-95-122, Mar. 6, 1995); and Small Business: Problems Continue With SBA's Minority Business Development Program (GAO/RCED-93-145, Sept. 17, 1993).

to direct an Indefinite Delivery Indefinite Quantity (IDIQ)³ contract to the firm, avoiding federal competition requirements.

The two high technology firms that were the focus of our investigation were I-NET, Inc. of Bethesda, Maryland, and TAMSCO of Calverton, Maryland. They were the third and ninth largest 8(a) firms, respectively, in terms of total dollars awarded for fiscal year 1992, a year when the top 25 of over 4,400 active 8(a) program participants received about 22 percent of the total 8(a) contract dollars. For the almost 10 years that both were in the 8(a) program, they were awarded over \$864 million in 8(a) contracts for computer systems and support services.⁴

SBA QUESTIONED 8(a) PROGRAM ELIGIBILITY ON ISSUE OF CONTROL

SBA regulations state that an 8(a) program applicant must unconditionally own at least 51 percent of the firm and control its operations. In 1984, SBA officials recommended that both I-NET and TAMSCO be denied acceptance into the 8(a) program because of eligibility issues regarding who controlled the firms. However, although SBA never fully resolved the questions about control of the firms, both were allowed entry into and remained in the program. In addition, both continue to benefit from contracts they received in the 8(a) program. Based on our review of SBA documentation and our interviews with SBA and other officials, we

³IDIQ contracts are used when agencies do not know the precise quantity of supplies or services to be provided and consequently are able only to estimate a minimum value. For purposes of IDIQ contracts, SBA regulations previously required competition whenever the guaranteed minimum value exceeded \$3 million. SBA recently amended its 8(a) regulations to eliminate the potential abuse of IDIQ contracts to avoid competition. 13 C.F.R. § 124.311(a)(2) (1995) requires agencies to competitively award any contract whose total value exceeds \$3 million for service contracts and \$5 million for manufacturing contracts. Effective Aug. 7, 1995, the applicable threshold amount is the agency's estimate of the contract's total value, including all options. The minimum value of the contract is no longer used.

⁴For fiscal year 1992, I-NET received over \$65 million in 8(a) contract awards. During its nearly 10-year (Sept. 20, 1984, to June 16, 1994) program participation, I-NET obtained 145 8(a) contracts totaling at least \$508 million. At least 126 of the 145 contracts were awarded noncompetitively.

For fiscal year 1992, TAMSCO was awarded over \$30 million in 8(a) contracts. During its program participation from May 14, 1984, until Sept. 18, 1993, TAMSCO obtained 108 8(a) contracts totaling at least \$356 million. At least 82 of the 108 contracts were awarded noncompetitively.

questioned SBA's justification for accepting I-NET and TAMSCO into the program.

SBA district officials four times recommended that I-NET not be admitted to the 8(a) program. However, a regional SBA official overturned district officials' objections and recommended I-NET's acceptance. He did so in a memorandum described by other SBA senior officials as using "circular reasoning" and "double talk."

SBA district officials had determined that I-NET's owner and president, Mrs. Kavelle Bajaj, lacked the knowledge and experience to run a high technology computer firm. They had further determined that Kuljit (Ken) Bajaj, Mrs. Bajaj's husband and a recognized expert in the field, would actually control and run the firm's operations. SBA had determined that Mr. Bajaj did not qualify for the 8(a) program because of his employment at a large computer firm. Furthermore, a former I-NET vice president told us that Mrs. Bajaj lacked the technical and managerial skills needed to run a computer company and that Mr. Bajaj had hired him in January 1985 to help start and run the firm and to "teach" Mrs. Bajaj how to run a business. Further, in 1988, Mr. Bajaj was appointed I-NET's Executive Vice President, replacing the previously mentioned vice president. Mr. Bajaj formally became I-NET's president after its 1994 exit from the 8(a) program. In addition, on the résumé he submitted to SBA's Office of Inspector General (OIG) during its 1992 I-NET audit, Mr. Bajaj stated that he was "responsible for day-to-day operations" of I-NET. Mrs. Bajaj was adamant with us that she unconditionally owned and controlled the firm. However, she provided us no explanation when asked how she controlled I-NET while, at the same time, her husband represented that he had the day-to-day responsibilities for the firm's operations.

With regard to TAMSCO, SBA district officials twice recommended that the firm's application for admittance to the 8(a) program be denied but were overruled. They were concerned that TAMSCO's nondisadvantaged vice president and 49-percent owner, William Bilawa, would improperly benefit from the 8(a) program. SBA officials knew that Mr. Bilawa had previously held supervisory positions over Mr. Innerbichler, Mr. Bilawa had had a higher salary than did Mr. Innerbichler, and the firm was initially based in Mr. Bilawa's residence. In addition, contrary to SBA regulations, TAMSCO's board of directors was initially structured so that its only two members, Mr. Innerbichler and Mr. Bilawa, had equal voting power.

Further, a former TAMSCO official told us that the two owners were "codependent" and functioned as equals. On his part, Mr. Innerbichler told us that (1) despite his previous relationship with Mr. Bilawa, TAMSCO's ownership was structured so that it would be eligible for 8(a) contracts and (2) it was agreed that he (Mr. Innerbichler) would maintain control of the firm's operations.

The senior SBA official who overturned the two recommended denials had no explanation as to why he had done so.

I-NET MISREPRESENTED ITS OWNERSHIP AND QUALIFICATIONS

Although SBA, under its regulations, could have terminated I-NET's 8(a) participation or suspended its contracts when it learned of misrepresentations by I-NET, SBA took no such action. I-NET had misrepresented its ownership status and qualifications to enter and remain in the 8(a) program: Mrs. Bajaj had submitted false and misleading information about the true equity ownership in I-NET, her educational credentials, and her citizenship status. Further, by the time that SBA learned of the misrepresentations, it knew that I-NET had exceeded 8(a)-program size restrictions for certain contracts. SBA could have terminated I-NET's participation or suspended these contracts for exceeding size restrictions but did neither.

Mrs. Bajaj failed to disclose to SBA, as required, that she had provided 24.5-percent ownership interests to each of two persons. Subsequently, Mrs. Bajaj submitted false statements to SBA that did not reflect these transactions: In 1986 and 1988, she falsely reported to SBA that 49 percent of I-NET's stock was unissued when a 24.5-percent ownership was still outstanding with one of the persons.

Mrs. Bajaj falsely certified on a résumé submitted to SBA with her 8(a) application that she held an Associate of Arts degree in computer science and technology. SBA did not suspend I-NET's contracts or terminate its participation in the 8(a) program after learning that Mrs. Bajaj had provided false information about her educational credentials. Mrs. Bajaj also misrepresented her U.S. citizenship status on her initial application, stating she was a citizen when at the time she was a resident alien.

SBA FAILED TO RECOGNIZE I-NET'S MISLEADING FINANCIAL INFORMATION

SBA regulations require it to verify that an 8(a) firm is a small business for each contract it receives. However, for several years SBA did not recognize or react to misleading financial statements from I-NET that served to misrepresent I-NET's size. I-NET submitted financial statements to SBA from 1988 through 1990 that excluded certain revenues from its total sales. I-NET explained the exclusion in notes to the audited financial statements; but SBA did not notice or act on the information in these notes until 1992. These exclusions enabled I-NET to obtain at least 11 contracts for which it was otherwise ineligible. However, I-NET included those revenues in its yearly total sales figures submitted to an investment firm when it was seeking private investors.

After determining that the excluded revenue should be included in assessing I-NET's size, in early 1993 SBA considered terminating certain I-NET contracts. I-NET responded that the firm had

difficulty maintaining adequate capital and credit and was "at risk." However, SBA determined, among other financial indicators, that I-NET had a \$25-million line of credit with its bank and was not at risk. Mrs. Bajaj told us, in defense of this apparent contradiction, that in her view \$25 million was not sufficient credit. However, in another apparent contradiction, during the same period when I-NET was seeking outside investment, I-NET described itself as having a backlog of over \$580 million in contracts and projected income through 1997 of about \$1.3 billion. Yet, in a written response to us concerning the risk issue, I-NET stated that at the time it was seeking outside investment, I-NET ". . . had severe cash flow problems and was having difficulty securing credit."

Further, SBA allowed I-NET to stay in the 8(a) program for almost 2 additional years after I-NET had exceeded its size limits and SBA officials had first recommended its early "graduation" from the program. Indeed, in January 1993, the SBA-OIG provided a draft audit report to the SBA office responsible for I-NET, recommending that no further contracts be awarded to I-NET because it had exceeded its size standards and had provided incorrect information to SBA for its annual size-standard determinations. However, until I-NET left the program in June 1994, SBA awarded I-NET additional contracts totaling at least \$62 million.

U.S. COAST GUARD USED IDIQ CONTRACT, AVOIDING COMPETITION REQUIREMENTS

As to the U.S. Coast Guard contract with TAMSCO, we determined that Coast Guard contracting officials had directed a noncompetitive 8(a) contract to TAMSCO, using the IDIQ contracting option and avoiding competition. They awarded the contract, with a potential maximum value of \$14 million, 1 day before TAMSCO's term in the 8(a) program expired in September 1993. The notes of one Coast Guard contracting official referred to this contract as a "graduation present" to TAMSCO. Coast Guard officials told us that the Coast Guard viewed competition of contracts as a hindrance to its mission and that it was always their intention to award the contract to TAMSCO. Thus, Coast Guard officials (1) changed the contract's original Standard Industrial Classification code, which TAMSCO had outgrown, to one for which TAMSCO qualified and (2) lowered the contract's original labor hours by 46 percent, to avoid the \$3-million threshold required for competitive IDIQ service contracts. This allowed the Coast Guard to award a noncompetitive IDIQ contract to TAMSCO.

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This concludes my prepared statement. I would be happy to respond to any questions that you may have.

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